BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 94-007-G - ORDER NO. 95-1253

JUNE 19, 1995

IN RE: Annual Review of Purchased Gas Recovery Procedures and Gas Purchasing Policies of South Carolina Pipeline Corporation.	)	ORDER RULING ON PGA AND GAS PURCHASING POLICIES

This matter comes before the Public Service Commission of South Carolina (the Commission) on its Annual Review of South Carolina Pipeline Corporation's (SCPC's, Pipeline's, or the Company's) Purchased Gas Adjustment (PGA) and Gas Purchasing Policies.

Commission Order No. 87-1122 provides that an Annual Review be conducted of SCPC's PGA and Gas Purchasing Policies. In SCPC's last review, the parties entered into a Stipulation resolving all issues which the Commission subsequently approved in Order No. 94-181, dated March 7, 1994.

In the Stipulation which the Commission approved in the last PGA case, the parties agreed not to challenge findings that, for the January 1993 to October 1993 period under review, Pipeline's purchasing practices were prudent, its PGA operated properly, and the purchased cost of gas was just and reasonable. The parties further agreed that a separate Docket would be opened to address FERC Order 636 issues. Additionally, the parties agreed to include November 1993 and December 1993 in the next annual PGA review or in a hearing on Pipeline's operations under FERC Order 636, whichever occurred sooner.

Pursuant to the present filing, Petitions to Intervene were filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate), South Carolina Electric & Gas Company (SCE&G), Nucor Steel, a Division of Nucor Corporation (Nucor Steel), the City of Greer (City), and the York, Lancaster, and Chester Gas Authorities (Authorities).

A hearing was held on this matter on April 26, 1995 at 10:30 a.m. in the offices of the Commission, with the Honorable Rudolph Mitchell, presiding. SCPC was represented by Mitchell M. Willoughby, Esquire, and Sarena D. Burch, Esquire. SCPC presented the testimony of Carlette L. Walker, W. Keller Kissam, and John D. McClellan. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire. The Consumer Advocate presented the testimony of Richard Hornby. Nucor Steel appeared and was represented by Garrett A. Stone, Esquire, and Russell B. Shetterly, Esquire. Nucor Steel presented no testimony. The Authorities were present and represented by Emil W. Wald, Esquire. The Authorities presented no testimony. SCE&G was represented by Francis P. Mood, Esquire. SCE&G presented no testimony. The Commission Staff was represented by F. David Butler, General Counsel, and the Staff presented the testimony of D. Joe Maready and James S. Stites. The City of Greer did not appear.

The annual PGA review of Pipeline's operations involves the following general issues:

(1) Whether Pipeline's purchasing practices were prudent during the period under review.

(2) Whether Pipeline's tariff was properly adhered to during the period under review.

(3) Whether or not adjustments to the tariff are needed on a prospective basis.

In this proceeding, certain specific issues flowing from the above general issues were raised. These additional issues were as follows:

(4) Whether or not Pipeline's Industrial Sales Program Rider (ISPR) should be modified.

(5) Whether Pipeline properly recovered Order 636 transition costs or whether the method of such recovery should be modified.

(6) Whether Pipeline's reserve margin was reasonable.

(7) Whether certain hedging activities should be approved.

With regard to the first general issue, Keller Kissam testified for SCPC. Kissam testified in some detail about Pipeline's recent purchasing practices, concluding that it was his opinion that these practices were prudent. This opinion was confirmed by the testimony of James Stites, Chief of the Commission's Gas Department. These witnesses were challenged only to a limited extent by the Consumer Advocate's testimony, and only then with respect to the amount of the Company's reserve margin. For these reasons, the Commission finds that Pipeline's purchasing practices were prudent during the period under review.

The second general issue with regard to Pipeline's tariff was addressed by Pipeline witness Carlette Walker. Walker described the procedures that the Company followed for gas cost recovery during the period under review, concluding that calculations had been made in accordance with the terms of its tariff and in compliance with the Commission directives. Joe Maready, a Public Utilities Accountant employed by the Commission Staff, presented the Commission Staff's audit of the Company's cost of gas, verifying that the cost of gas for the period in question had been properly accounted for. Additionally, James Stites testified that the Gas Department had determined that the cost of gas was being properly recovered under Pipeline's tariff. No contrary evidence was presented to the Commission. The Commission therefore concludes that Pipeline's tariff was properly adhered to during the period under review. Accordingly, we find that SCPC's cost of gas was properly recovered under its tariff.

With regard to the first specific issue in the case, Pipeline proposed to make three changes to its tariff's PGA clause on a prospective basis. First, Pipeline proposed to revise Paragraph 7(b)(4) by eliminating any reference to propane air production costs and by including recovery of liquefaction costs. Second, Pipeline proposed to change Paragraph 7(b)(8) so as to directly associate term gas supplies at prices which may be fixed through hedging activities for the purpose of allowing multiple-month sales to industrial customers. Neither of these changes was opposed by any party, and the Commission therefore finds that these proposed revisions should be approved.

The final PGA clause change was to add Paragraph 7(b)(12) so as to allow recovery of the direct costs of a hedging program. This change was opposed by the Consumer Advocate. The issue is discussed in more detail below, as is the the Consumer Advocate's proposed changes to Pipeline's tariff.

With regard to the Company's ISPR Program (Industrial Sales Program Rider), the Consumer Advocate argues that Pipeline's ISPR needs to be modified because of changes in gas supply contracting and capacity options brought about by implementation of FERC Order 636 in November 1993. The evidence shows, however, that the current design of the ISPR has served all of Pipeline's customers well, even after implementation of FERC Order 636. A review of the evidence leaves the Commission to believe that SCPC's ISPR should not be modified at this time.

The Consumer Advocate first contends that the allocation of gas costs under the current ISPR results in higher commodity costs to firm sales customers than they would have paid in the absence of sales to interruptible customers. Through witness Richard Hornby, the Consumer Advocate proposed to modify the ISPR prospectively so that Pipeline would recover its average commodity cost of gas from interruptible sales. Had Pipeline's ISPR been so modified in 1994, Hornby contended firm customers would have saved $1.4 million in gas supply costs.

The record reflects that Pipeline recovered gross margins from the current ISPR of approximately $24.7 million during 1994. More importantly, in that same period, direct and indirect benefits to firm customers totaled in excess of $2.7 million, which is nearly twice the amount that would have been saved under the Consumer Advocate's proposal. Thus, the Commission finds that in terms of recovering the cost of gas, the current ISPR actually benefits firm customers more than the modification proposed by the Consumer Advocate.

Second, the Consumer Advocate contends that under the current ISPR, Pipeline is losing potential revenue credits for firm customers by selling excess capacity to interruptible customers instead of "releasing" it to third parties on the secondary market. Hornby estimated that, if the ISPR had been modified in 1994 to reflect the market value of firm transportation capacity used to make industrial sales, firm customers would have received between $1 million and $6 million in revenue credits from the released capacity.

According to SCPC, Hornby's recommendation and calculations concerning capacity release were based on an assumption that has no basis in the evidence. The Commission agrees with SCPC's assertion. Hornby assumed that there is a secondary market in which Pipeline's excess capacity could be released. Hornby admitted, however, that he had not actually investigated the available market for excess capacity, but that it was his impression that "there wasn't a lot of activity in terms of release...." It is apparent from the record, then, that Hornby merely assumed a "capacity release" market exists when all indications are that this is not the case.

The record of the case at bar reflects that the current ISPR benefits all of Pipeline's customers, including its firm customers. In addition to the significant contribution to recovery of gross margins and the substantial revenue credits for firm customers previously mentioned, the program also allows Pipeline to obtain natural gas on better terms and lower prices in spot gas markets, enables Pipeline through its curtailment plan to make lower cost volume and capacity available for immediate use by firm customers when core market demands suddenly increase, and provides a degree of operational and cost stability for the core market which could not be met by any other means. In other words, the Commission believes that the ISPR provides a considerable amount of additional reliability to Pipeline's firm sales customers. James Stites, Chief of the Gas Department, testified that the continuation of the ISPR is warranted without any changes or modifications. The Commission therefore rejects the modifications to the ISPR proposed by the Consumer Advocate, and holds that the ISPR Program shall be continued in an unmodified fashion.

With regard to FERC Order 636 transition costs, the Commission concludes from the record that Pipeline properly recovered FERC Order 636 transition costs under its tariff, and the method of recovering such costs should not be modified. FERC Order 636 transition costs and, more particularly, Gas Supply Realignment (GSR) costs arose as a result of a FERC Order requiring interstate pipelines to unbundle their merchant services. As a result of this

Order, it was necessary for the interstate pipelines to buy down or buy out term contracts that had been procured to supply the merchant service which they had previously provided. FERC Order 636 allowed the interstate pipelines to pass these GSR costs on to their customers such as Pipeline.

It is undisputed that, during the period under review, Pipeline incurred GSR and other FERC Order 636 transition costs. The Commission must conclude after examination of the evidence in the record that these costs were properly passed through to Pipeline's customers under the PGA clause of Pipeline's tariff.

It should be noted that the Consumer Advocate proposes to retroactively modify the tariff so that GSR and the other FERC Order 636 transitions costs are recovered from all customers on a volumetric basis. The Commission rejects this proposal for a number of reasons.

First, if such a proposal was adopted, the effect would be to give firm customers a credit of $6.9 million for amounts lawfully collected under Pipeline's tariff, which was on file with the Commission. This violates the filed rate doctrine and would constitute retroactive ratemaking, in contravention of established precedent in this State. Hornby conceded that this issue could and should have been presented in the PGA case last year. This Commission cannot approve a rate charge retroactively.

Further, the proposal should not be adopted prospectively. The basis for the proposed modification is Hornby's assertion that all customers contributed to the FERC Order 636 costs being incurred. However, it is noteworthy that the GSR costs are directly related to the interstate pipelines' acquisition of gas supply to provide firm merchant service and the subsequent buy-out of the long-term contracts for such service after FERC Order 636. Therefore, the Consumer Advocate's position is again based on an incorrect assumption.

In any event, under the proposed settlement with Southern Natural Gas pending before FERC, Pipeline's GSR charges are being eliminated. The Commission has taken judicial notice of this settlement document on file with FERC. Accordingly, when the settlement is approved by FERC, the GSR cost recovery issue will become moot.

For these reasons, the Commission holds that the GSR and other FERC Order 636 transition costs were properly recovered under Pipeline's current tariff. The Commission thereby rejects the modification proposed by the Consumer Advocate.

With regard to SCPC's reserve margin during the period under review, the next specific issue, the Commission concludes that said margin was reasonable, upon examination of the evidence.

The Consumer Advocate argues that the Commission should disallow the recovery of the costs associated with Pipeline's acquisition of 10,000 Mcf/day of additional capacity from Southern Natural Gas. Hornby contended that this represents the amount of excess capacity over a reasonable reserve margin for SCPC of approximately 28%. Pipeline submits, and the Commission holds, that Hornby's calculations were based upon an erroneous assumption and that his testimony actually supports the reasonableness of the Company's reserve margin.

Hornby originally calculated Pipeline's reserve margin to be 31%. The record reflects that this calculation erroneously designated 7,943 Dt/day of FS service on Transco as capacity, when this amount actually represents gas supply. Hornby admitted that removing this amount from capacity resulted in the reduction of Pipeline's reserve margin to approximately 29%. He also admitted that the difference between a 28% and 29% reserve margin was insignificant. Based upon this, Pipeline submits and the Commission holds that the Company's reserve margin during the period in question was reasonable. The Commission also approves the recovery of all costs associated with the acquisition of capacity during that period.

The final specific issue to be addressed concerns Pipeline's request to be allowed to recover the direct costs of maintaining a hedging program for system supply gas. If approved, this would necessitate the amendment of the Company's tariff to reflect the recovery of these costs through the PGA.

SCPC's witness John McClellan testified in detail concerning the hedging concept proposed by Pipeline and the benefits which hedging would provide to Pipeline's customers. Although a relatively recent development within the natural gas markets, according to McClellan, hedging of system gas supply should, over time, bring about price stability, transfer to others the risk of price volatility, and minimize or reduce the cost of gas. The

Company could track hedging activity daily and report the results to the Commission monthly.

Consumer Advocate witness Hornby objected to the hedging proposal, because he believed that it would impose undue risks on Pipeline's firm customers without any benefits. He also considered the proposal too vague. Hornby admitted that he had no expertise in hedging. In the alternative, he did support approval of a hedging program on a "pilot" basis with a ceiling on the level of of losses that could be recovered.

Since this concept is new to this Commission and to the regulatory process in South Carolina, Pipeline states that it is willing to implement the program on a trial basis with certain volume and time limitations. Pipeline has stated in its brief that a fair trial program would limit hedging by no less than 30% of Pipeline's system supply gas for a period no less than one year. During the time the program is in effect, results from hedging activities would be reported to the Commission monthly in reports which Pipelines files with the Commission. In addition, regular reviews of the functioning of hedging activities could be conducted by the Commission Staff.

The Commission has considered this matter and believes that the hedging proposal should be conducted in South Carolina on a trial basis in a pilot program. This pilot program shall allow hedging for a period of one year, begining with the date of this Order, limited to 30% of the system supply. During this time, hedging activities are be to reported to the Commission monthly.

At a minimum, the data must include the information shown on Appendix A to this Order. This report is to be orally given to the Commission during the Commission meetings, and the Staff shall monitor hedging activities on a regular basis. The Commission may order modification or termination of the trial period at any time, if we determine that the program has become detrimental to the interests of the ratepayers of South Carolina. Accordingly, Pipeline's proposed modification to Paragraph 7(b)(12) to allow for recovery for direct cost of this program is hereby granted.

The Commission has examined the testimony of the witnesses, and the entire record of this case, and hereby denies all other proposals presented to this Commission in this Docket, not consistent with the holdings stated herein.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Rudolph Mitchell
Chairman

ATTEST:

Gary E Walsh
Deputy Executive Director

(SEAL)

APPENDIX A
Docket No. 94-007-G
Order No. 95-1253

Reporting Requirements

Report on a monthly basis the Company's participation in the futures market to include the following:

a. Identify each transaction made during the month and include the volumes associated with each transaction along with cumulative totals from inception of the Company's participation. (Identify the cumulative percentage participation with total contracted supplies.)

b. Locked in price/dekatherm and delivery date (the month or time period that the proceeds from the contract are to be applied to) of each contract.

c. The actual monthly cost of gas, in dollars, entering the Company's system less any proceeds from futures market transactions and compared with the cost of gas reflecting any futures market transactions for the month. If there are no proceeds for a given month please indicate none.

d. From inception of the Company's participation show on a cumulative basis a comparison of the cost of gas, in dollars, less any proceeds from futures market contracts, and the cost of gas reflecting proceeds from futures market transactions. If there have been no proceeds for a given period please indicate none.

e. Provide by month and on a cumulative basis, from inception of the program, the dollars spent along with an explanation of the expenditures (Commissions, Legal fees, etc).

f. Provide notification of termination of each contract along with the reason for termination.